

Oakland Unified School District:

**Current Practices Have Improved
Its Financial Condition**

August 1996
96105.1

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CALIFORNIA STATE AUDITOR

August 21, 1996

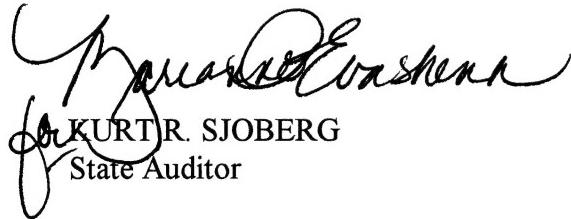
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The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the Oakland Unified School District's current financial condition, its classification of costs for State reporting purposes, and the actions the district has taken in response to the Office of the Auditor General's 1989 and 1990 reports on the district. This report concludes that the Oakland Unified School District has improved its financial condition and has projected that it will have approximately the State's recommended level of reserve in its general fund for fiscal year 1995-96. However, we found the district does not always correctly classify and thereby allocate program costs in the automated accounting system it uses to prepare reports for the State. Finally, although the district has improved its management controls since the reports issued by the Office of the Auditor General identified weaknesses in this area, it needs to further tighten its controls over payroll and facilities' keys.

Respectfully submitted,


for KURT R. SJOBERG
State Auditor

Enclosure

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Summary

Results in Brief

Audit Highlights . . .

We reviewed Oakland Unified School District's current financial condition and management practices and found the district's:

- Financial position has improved over the past five years ending fiscal year 1994-95 with a \$4.3 million unrestricted fund balance.***
 - Classification of instructional costs could be overstated by as much as \$1.5 million.***
 - Management controls have improved since the 1990 state audit; however, minor weaknesses still exist.***
-

Located in Alameda County, the Oakland Unified School District (district) has had a history of financial and management difficulties. These problems led to a review by the Office of the Auditor General (OAG), which issued in 1989 and early 1990 three reports that detailed the district's difficulties. The State subsequently enacted two bills to address the district's problems and to avert similar troubles in other school districts.

Between 1990 and 1996, with the assistance of an advisory trustee and the Alameda County Office of Education, the district continued to execute its plan to control expenditures, increase revenues, augment reserves, and implement automated management and accounting systems.

Our review focused on an assessment of the district's current financial position and on the classification of costs reported as instructional, administrative support, and pupil services. Further, to follow up on issues raised in the OAG's 1990 reports on the district, we determined what actions, if any, the district has taken to correct the problems identified previously.

During our audit, we noted the following improvements and concerns:

- Between fiscal years 1989-90 and 1994-95, the district's financial condition improved. The district ended fiscal year 1994-95 with a fund balance of \$4.3 million in its unrestricted general fund. As of June 21, 1996, the district's unaudited financial reports for fiscal year 1995-96 estimated an ending fund balance of \$7.4 million in its unrestricted general fund.
- For fiscal year 1994-95, the district's reserve designated for economic uncertainties was \$3.9 million, \$1.1 million below the State's recommended level and \$.3 million below the goal contained in its Five Year Recovery Plan with the

State and county. For fiscal year 1995-96, the district's unaudited financial reports estimated a reserve of \$5 million designated for economic uncertainties, an amount approximating the State's recommendation.

- According to its recent labor agreement with the teachers' union, the district is attempting to control the risk regarding the availability of adequate funding for salary increases in the future. In fiscal years 1997-98 and 1998-99, teacher pay increases will be limited to the State's cost-of-living adjustment for the revenue limit apportionment (the amount the State allots to the district for average daily attendance), minus one percent, plus any amounts received for previously unfunded revenue limit apportionments. However, for fiscal year 1997-98, the estimated teachers' pay increases will still exceed increased revenues.
- The district does not always correctly classify and thereby allocate program costs in the automated accounting system that it uses to prepare its Annual Program Cost Data Report (J-380). We calculated that the district's cost of instruction for fiscal year 1995-96, as accumulated by its accounting system, could be overstated by as much as \$1.5 million. For example, the district's automated accounting system was accumulating as instructional costs a total of \$740,000 for on-loan employees performing services for other entities, \$670,000 for teachers on special assignment (TSA) performing school site and district office administrative duties, and \$125,000 for retired teachers performing administrative duties.
- The district also incorrectly classified as school site rather than district office administration a total of \$490,000 in costs for five assistant or associate superintendents.
- The district has tightened its management controls since the 1990 audit by the OAG, but more improvement is needed. For 10 of the 37 OAG recommendations, we determined that no follow-up was necessary. Our review also found that the district had implemented 20 of the OAG recommendations. To respond to the remaining 7 OAG recommendations, the district needs to tighten its controls over payroll, consulting contracts, and access to keys that open district facilities.

Recommendations

To ensure that it categorizes and reports expenditures in accordance with state instructions, the district should do the following:

- Report as nonagency activities on its J-380 the cost of on-loan employees who are under contract to another educational entity;
- Allocate to the appropriate budget code the cost of employees, such as TSAs, who perform various duties;
- Report on its J-380, all costs for assistant superintendents as district administration costs; and
- Review periodically, and at least annually, the duties performed by its employees.

To make certain that it pays employees only what they are entitled to receive, the district should direct its internal auditor to focus on potential payroll problems, including supervisors' approval of time sheets and the types of clerical errors we identified, such as incorrect recording of employee time worked and leave taken.

Agency Comments

The district is committed to addressing the recommendations in the report and provides its rationale for specific actions. The district commented that the misclassifications are prospective and represent projected overstatements and understatements of costs. In addition, it expressed concern that our scope did not include determining the extent that other districts may have misclassified costs.

Introduction

The District's Structure and Size

The Oakland Unified School District (district) is administered by a superintendent in accordance with policies approved by its seven-member board of education (board). The board members, elected officials serving staggered four-year terms, appoint the superintendent, who is responsible for preparing and submitting to the board a budget for each fiscal year.

With 51,706 students enrolled in 90 schools, the district is located in Alameda County and is the sixth largest school district in California. In fiscal year 1995-96, the district had unrestricted general fund operating expenses of approximately \$164 million. On June 26, 1996, the board adopted the district's budget for fiscal year 1996-97, which projected unrestricted general fund expenditures of approximately \$169 million.

The District Previously Experienced Financial and Management Problems

In the past, the district had financial and management problems. In late 1989 and early 1990, the Office of the Auditor General (OAG) issued three reports detailing these issues. In October 1989, the State enacted Assembly Bill (AB) 2525, which required the superintendent of public instruction to appoint a trustee for the district. Between November 1989 and June 1993, a trustee served the district in an advisory capacity. In May 1993, the California Department of Education (department) determined that the trustee position was no longer needed. The department based its decision in part on the passage of AB 1200, which provides to county offices of education additional powers for reviewing their districts' interim financial reports.

The District's Reporting Requirements

In administering the State's K-12 education system, the department requires school districts to submit various cost and program reports to aid decision makers, both inside and outside the department, in their budgeting, monitoring, and planning. One of the required reports, the Annual Program Cost Data Report (J-380), shows by program how a school district spends its resources. The J-380 reports both direct costs for each program and an indirect cost rate for the school district.

The District's Current Environment

In early 1996, the district's teachers went on strike. One of the issues raised by the teachers' union was that the district was spending too much of its operating budget on administration and too little on classroom instruction. The teachers ended their strike during the latter part of March and ratified a new contract with the district.

The Bureau of State Audits (bureau) was asked to review the district's reported administrative costs. Following its review, the bureau issued in March 1996 a report entitled "Oakland Unified School District: A Review and Comparison of Various Costs (96105)." The bureau examined the cost data submitted on the J-380, and it compared the district's reported costs for providing education to its students with those reported by six comparable school districts.

Scope and Methodology

The Joint Legislative Audit Committee requested that the bureau review and assess the district's current financial position; evaluate the accuracy and propriety of the costs and personnel classified and reported as instructional, administrative support, and pupil services; and follow up on issues raised in the OAG's 1990 reports on the district to determine what actions, if any, the district has taken to correct the problems identified.

To assess the district's current financial condition, we reviewed the district's audited financial statements for fiscal year 1991-92 through fiscal year 1994-95, its estimated revenues and expenditures for fiscal year 1995-96, its approved budget for fiscal year 1996-97, and its projections for fiscal years 1997-98

and 1998-99. Moreover, we analyzed the new agreement between the district and the Oakland Education Association that covered teachers and other certificated employees.

Because the procedures cited above were not sufficient to constitute an examination of the financial statements made in accordance with governmental auditing standards, we do not express an opinion on any of the financial statements referred to in this report.

To assess the accuracy and propriety of costs related to instruction, administrative support, and pupil services, we reviewed the costs submitted by the district on its J-380. We examined policies, procedures, and guidelines to define and identify instructional and administrative costs and to determine reporting requirements. To assess the accuracy and propriety of personnel classified and reported as noted above, we determined whether employees classified as instructional actually provided instruction to students in the classroom. Also, we determined if employees reported as having instructional administration or school administration functions performed appropriate services either in direct support of instructional programs or at the school sites.

The scope of our audit was not to restate prior data submitted by the district nor to compare the district with other districts in the State. Rather, our purpose was to evaluate the district's process for preparing the J-380 and to identify discrepancies between how the district's automated accounting system is summarizing costs for the district's J-380 and how the State directs districts to report costs on their J-380 forms.

To determine actions the district has taken to correct the problems identified in the OAG's 1990 reports, we reviewed the district's response to the reports. Further, to evaluate the district's internal controls over its payroll, personnel, inventory, and procurement, we reviewed the financial audit work papers of its external auditors and examined the district's current policies, procedures, and practices.

Chapter 1

The Oakland Unified School District's Current Practices Are Achieving Balanced Budgets, Adequate Reserves, and Controlled Teacher Salary Increases

Chapter Summary

Between fiscal years 1989-90 and 1995-96, the Oakland Unified School District (district) improved its financial condition significantly. The district anticipates a \$7.4 million fund balance in its unrestricted general fund for fiscal year 1995-96 and estimates that its reserve will approximate the State's recommendation that school districts maintain a reserve equal to 2 percent of their expenditures and other financing uses. Also, the district is attempting to control expenditures by having its new labor agreement with teachers include a provision that limits future salary increases to a portion of revenue increases. However, for fiscal year 1997-98, the estimated teacher pay increases will still exceed the district's expected increased revenues.

Background

During 1989, the district had financial and management problems. The district's external auditor reported that the district had no reserve designated for economic uncertainties, and its reserve for self-insurance programs was underfunded by \$4 million. In its report entitled "A Review of the Oakland Unified School District's Financial Condition," issued January 1990, the Office of the Auditor General (OAG) recommended that the district implement a comprehensive plan to reduce its expenditures, increase its revenues, or both. In addition, the State enacted Assembly Bill (AB) 2525. This law provided that an advisory trustee be appointed by the State's superintendent of public instruction to assist the district with its financial and management problems.

Beginning in fiscal year 1989-90, the district and the board of education (board) worked with an advisory trustee, the Alameda County Office of Education, and the California Department of Education (department) to remedy budget issues and to establish

agreed-upon reporting and review procedures. The district developed a five-year financial and management plan that it implemented over fiscal years 1990-91 through 1994-95.

In October 1991, the State took additional measures intended to prevent financial and management problems from occurring in school districts. The State enacted Assembly Bill (AB) 1200, which gives to the county offices of education additional powers for reviewing districts' interim financial reports. Additionally, since June 1993, to supplement its own review, the Alameda County Office of Education has contracted with the district's former trustee to review the district's interim financial reports and annual budget.

The District's Financial Condition Has Improved

After implementing a five-year improvement plan, the district's general fund has gone from a \$7 to \$12 million deficit to a positive \$4.3 million balance.

Between fiscal years 1989-90 and 1995-96, the district made noteworthy improvements in its financial condition. During 1989, the district's external auditor estimated that the deficit in the district's general fund ranged from \$7 to \$12 million. Between 1990 and 1995, the district implemented a five-year plan to improve its financial condition. The district was assisted by an advisory trustee and the Alameda County Office of Education, the office charged with executive oversight of the district. The district controlled expenditures, increased revenues, and augmented reserves. Also, it implemented automated systems for attendance and financial accounting; payroll and personnel; and budgeting. The district ended fiscal year 1994-95 with a positive fund balance of \$4.3 million in its unrestricted general fund. Further, as of June 21, 1996, the district's unaudited financial reports for fiscal year 1995-96 estimate an ending fund balance of \$7.4 million in its unrestricted general fund.

Appendix A, on page 27, presents district financial information. Included in Appendix A is the district's actual unrestricted general fund balance as of June 30, 1995; its estimated fund balance as of June 30, 1996; its budgeted fund balance for 1997; and its projection of fund balances for 1998 and 1999. For fiscal year 1994-95, the district's reserve designated for economic uncertainties was \$3.9 million, which, as reported by its external auditor, was \$1.1 million below the State's recommended reserve. The State recommends that districts maintain a reserve for uncertainties equal to 2 percent of expenditures and other financing uses. Also, this reserve was \$300,000 below the target level of \$4.2 million for June 30, 1995, a figure contained in the five-year plan the

district prepared for submission to the county and the department. However, for fiscal year 1995-96, the district estimates a reserve of \$5 million designated for economic uncertainties, an amount that approximates the State's recommended level of reserve.

The District Anticipates That Its Fund Balance Will Increase

The district's general fund consists of funds designated for unrestricted and restricted programs. The unrestricted program funds go to the basic operation of grades K-12 including employee salaries, textbooks, office supplies, equipment, and most administrative functions. The restricted program funds primarily cover special programs, such as the Special Education and the School Improvement programs. For fiscal year 1996-97, the district's approved general fund budget of \$257.3 million consists of planned unrestricted and restricted program expenditures of \$168.7 million and \$88.6 million, respectively. The budget for fiscal year 1996-97 anticipates the fund balance of the unrestricted general fund increasing by \$600,000, from \$7.4 million to \$8 million. In addition, the budget shows the reserve designated for economic uncertainties increasing from \$5.0 million to \$5.1 million. The \$5.1 million reserve approximates the 2 percent reserve that the State recommends. In Appendix B, on page 31, we provide actual, estimated, and projected fund balance reserves of the district's unrestricted general fund for fiscal years 1994-95 through 1998-99.

The District Is Controlling Teacher Salary Increases Through Its New Labor Agreement

The district reduced its budgeted expenditures in fiscal year 1996-97 for administration by \$2 million to pay for salary increases for teachers and others.

The district is controlling expenditures through its four-year labor agreement with its teachers. In March 1996, the district's teachers ratified a labor contract that extends through fiscal year 1998-99. To generate sufficient funds to pay for salary increases for teachers and other employees, the board approved the district's budget reducing central office and school site administration costs for fiscal year 1996-97, year two of the teachers' contract, by approximately \$2 million. In addition, the contract with the teachers provides for an increase in the ratio of students to counselors, thus reducing the number of counselors in the district. The district had estimated that the reduction in counselors would save the district an additional \$1.3 million in salaries and benefits. However, before the end

of fiscal year 1995-96, the district restored all the counselor positions for one more year because it used "one-time" sources—savings from the teachers' strike—to pay for the counselors. Despite the reinstatement of the counselor positions, the district's fiscal year 1996-97 budget is balanced and provides for an adequate fund reserve.

The district controlled the risk regarding the availability of adequate funding for salary increases in future budgets. The March 1996 labor agreement with the teachers specified one-time bonuses ranging from \$2,700 to \$3,200 for fiscal year 1995-96. These were supplemental payments that did not change the salary schedules on which the district would base future increases. For fiscal year 1996-97, the change in pay for teachers averaged 5.47 percent, consisting of an approximately 3 percent increase for the first seven months and an approximately 12 percent increase for three months. Thus, the district will base future salary changes on the June 1997 rate, which was 12 percent higher than the June 1996 rate.

According to the labor agreement for fiscal years 1997-98 and 1998-99, the teachers' salary schedule will increase according to the funded cost-of-living adjustment (COLA) for the revenue limit apportionment, minus one percent, plus any revenue limit deficit reduction percent. The revenue limit apportionment, which is funding the district receives from the State based on average daily attendance (ADA), represents about 92 percent of the district's unrestricted general fund revenue. According to the assistant superintendent for business services, the district will use the one percent for benefits and operating expenses, such as utilities and supplies. A deficit reduction may occur because, in the past, the revenue limit apportionment has not always been funded at the statutorily required amount.

By tying future teacher salary increases to the State's revenue limit COLAs, the district is attempting to ensure that sufficient revenues are available to pay for long-term commitments.

The contractual agreement between the district and its teachers will limit teacher payroll costs during periods when the State does not fund an increase in the revenue limit apportionment. Because salaries and benefits make up about 74 and 20 percent, respectively, of the district's unrestricted general fund expenditures, this method of providing additional pay limits the district's risk of long-term commitments to increase employees' pay when future revenue sources are unknown. However, despite the agreement, the district expects teacher pay increases to exceed increased revenues in the third year of the teachers' contract.

Specifically, the district's projection for fiscal year 1997-98 estimates that funding from the revenue limit apportionment will increase by \$5.5 million. This additional revenue consists of \$3.9 million arising from a 2.3 percent projected increase in the

COLA and \$1.6 million from a projected growth in ADA. The additional revenues will be insufficient to finance the projected increase in teacher salaries of \$6.3 million and other salaries of \$.2 million. The raises in teacher salaries will be based partially upon the district increasing its fiscal year 1997-98 salary schedule by 1.3 percent above the June 1997 salary schedule. However, as stated previously, the June 1997 salary schedule will be 12 percent higher than the June 1996 salary schedule.

For fiscal year 1998-99, the district projects that revenue limit apportionment funding will increase by \$4.9 million because of a 2.86 percent COLA. The increase is sufficient to finance the projected increase in both teacher salaries of \$1.5 million and other salaries of \$.8 million. Both types of salaries are expected to increase at a 1.86 percent rate.

In addition to the labor agreement with the teachers, the district has labor agreements with nine other bargaining units representing district employees. According to the assistant superintendent for human resources, the district is in full contract negotiations with three bargaining units. Further, as of August 7, 1996, he stated that the district will be involved with three other bargaining units in wage re-openers that the district expects to be completed within the next three months. These wage re-openers provide for contract renegotiations under certain circumstances.

Chapter 2

The District Has Not Classified Some of Its Costs Correctly

Chapter Summary

Although the Oakland Unified School District (district) classified most of its costs correctly, it understated some administrative and nonagency activities costs by incorrectly classifying them as instructional. The district uses its accounting records to prepare the Annual Program Cost Data Report (J-380) it submits to the California Department of Education (department). Although it has the systems capability to report costs correctly, the district made these errors because it does not allocate in its automated accounting system a proportion of some employees' time according to the work they perform. In other cases, the district's accounting records were in error because they did not classify employees in accordance with the California School Accounting Manual (CSAM).

We calculated that the cost of instruction for fiscal year 1995-96, based on costs accumulated in the district's automated accounting system, could be overstated by as much as \$1.5 million. We found that the district incorrectly classified as costs of instruction approximately \$740,000 for employees on loan to provide services to other entities; approximately \$670,000 for teachers on special assignment (TSAs); and approximately \$125,000 for early retirees providing service to the district. The misclassification for the TSAs is a projection to the universe of 119 TSAs based on the 40 percent error rate in our sample of 25 TSAs. These three groups of employees either were not providing services to the district or were performing administrative duties rather than instructing students. Further, we found that the district incorrectly classified as a cost of school site administration approximately \$490,000 in salaries paid to an associate superintendent and several assistant superintendents of instruction. The salaries for these employees should be classified as a cost of district administration. Although these misclassifications represent less than one percent of total expenditures, they indicate that the district needs to change its procedures to classify correctly those types of costs in accordance with the CSAM.

Background

Each October, the district submits to the department its J-380 report, which summarizes the district's general fund expenditures by program and activity (function). Specifically, the report lists direct expenditures for various types of activities within such specified programs as instructional programs, special projects, and support services. For example, the types of activities within the support services program include school administration, district administration, and centralized data processing. The district also uses the J-380 to develop an indirect cost rate for those expenditures that cannot be directly allocated to a program. Because the district had not yet prepared its J-380 for fiscal year 1995-96, we focused our review on how the district classified costs in its automated accounting system, which accumulates costs for the J-380, rather than reported costs during fiscal year 1995-96. Our objective was to evaluate the district's process for preparing the J-380 and to identify discrepancies between how its automated accounting system was summarizing costs for the district's J-380 and the department's directions for reporting costs on the J-380.

The J-380 form classifies a school district's instructional and administrative expenses. Some categories of expense have a higher potential for misclassification.

The costs included in the J-380's "cost of instruction" classification consist mainly of salaries for classroom teachers and instructional aides, benefits for these employees, and classroom supplies. The district has two groups of teachers: regular classroom teachers and TSAs. The district employs approximately 2,560 regular classroom teachers and 140 TSAs. A TSA has the "on-special-assignment" designation because he or she, although certificated to teach in the classroom, frequently provides the district with services outside the classroom. For example, TSAs provide in-service training of classroom teachers, develop curriculum, administer diagnostic tests, tutor students to help develop certain skills, or perform administrative tasks. Therefore, the district should report TSA salaries as instructional costs only to the extent that the TSAs' duties require direct interaction with students.

We reviewed the district's J-380 form and determined that certain cost categories have a higher potential for misclassification. For example, the district might misclassify salaries and wages for those employees who are officially listed as instructional but who have a work location other than a school site as well as salaries and wages for those individuals performing more than one function for the district. Because of this potential for error, we sampled three groups of employees. The first sample consisted of employees the district identified as "on loan." As employees of the district, these individuals are under contract to perform work for another educational entity.

While on loan, the employees receive from the district their regular salary plus benefits, and the district usually receives full reimbursement from the other educational entity. Our second sample consisted of employees who are classified as instructional and who have a district-office work location. The last sample consisted of TSAs.

The District Misclassified the Costs of On-Loan Employees and Early Retirees

For J-380 reporting purposes, an on-loan employee does not represent a true district instructional expenditure. The CSAM provides direction to school districts for program cost classification for the J-380. According to the CSAM, instructional programs include general education instructional programs and activities as well as "those costs that relate directly to the general education instructional programs, such as salaries of teachers, salaries of instructional aides, (and) employee benefits for teachers and instructional aides. . . ." The CSAM specifically excludes "costs of general education programs operated on behalf of or under contract to another educational agency (these costs are charged to the nonagency activities educational program)."

According to our review of the district's accounting records and its on-loan employees' salaries, the district overstated its instructional costs and understated its nonagency activities costs. For fiscal year 1995-96, the district had 16 employees on loan to various educational entities, including Mills College in Oakland and the University of California. We determined that the district classified on-loan employees as instructional in its accounting records for 1994-95 and 1995-96. According to the district's assistant superintendent of business services, salaries and wages for the 11 employees who were on loan during fiscal year 1994-95 were included as an instructional expense in the district's J-380 for that same fiscal year. If the district continues to follow this classification method, on-loan employees will be included in the total instructional expenditures reported on its fiscal year 1995-96 J-380. Thus, the district may overstate the cost of instruction because these employees did not provide services directly to the district or its students, and the employees should not be classified or reported as instructional. Based on our review of the salaries paid to the 16 on-loan employees from July 1, 1995, through April 30, 1996, as accumulated in the accounting system, and adding employee benefits at 25 percent of salary, we determined that the district has overstated its instructional costs by as much as \$740,000 and understated its nonagency activities costs by the same amount.

*The misclassification of
16 on-loan employees
overstated instructional
costs by as much as
\$740,000 for fiscal year
1995-96.*

In addition to examining records relating to the on-loan employees, we reviewed the records for 13 employees classified as instructional and having a work location other than a school site. We interviewed the employees' supervisors to determine if the duties the employees performed were consistent with the classification. We concluded that the duties performed generally conformed to the classification.

However, in the course of this review, information given to us from the district indicates that employees working under the early retirement incentive program are misclassified as instructional. For example, some early retirees, who are classified as instructional, work on the district United Way Campaign, operate the early retirement incentive program, assist the district library program, and reorganize district files. The CSAM states that the cost of retirees should be classified based on the work they perform. Based on our review of amounts paid to certain early retirees, as accumulated in the accounting system, we estimate that instructional costs are overstated by \$125,000, and school site administration and district office administration are understated by \$55,000 and \$70,000, respectively.

***The District Does Not Always Allocate
the Instructional and Noninstructional
Costs of TSAs Correctly***

For fiscal year 1995-96, the district funded 119 TSA positions through its general fund; therefore, the district will include the TSAs' salaries in the expenditures reported on its J-380. For 10 (40 percent) of the 25 TSA positions we tested, we determined that the positions' classifications did not agree with the duties performed. Specifically, 7 TSAs whom the district had classified as instructional spent all or part of their time performing school site administrative duties. Conversely, costs for 3 of the 10 TSAs were classified as school site administration; however, these TSAs' duties were not limited to such administration. We found that the 3 TSAs spent a portion of their time in the classroom instructing students as well as performing district office administrative duties.

40 percent of the TSAs we tested were misclassified, most as instruction rather than school site or district administration.

Based on our review of the salaries paid to the 10 TSA positions from July 1, 1995, through April 30, 1996, as accumulated in the accounting system, and adding employee benefits at 25 percent of salary, the district's instructional costs are overstated by \$140,000, school site administration costs are understated by \$130,000, and district office administration costs

are understated by \$10,000. Although we did not take a statistically valid sample, if the 40 percent classification error rate in our sample of 25 TSAs is representative across the 119 TSAs, the district's instructional costs could be overstated by as much as \$670,000, school site administration costs could be understated by as much as \$620,000, and district administration costs could be understated by as much as \$50,000.

As a result of misclassifying its TSAs, the district could be overstating its instructional costs by as much as \$670,000.

It is important for the district to classify correctly the range of duties performed by employees; inaccurate information does not aid decision makers or the decision-making process. For example, inaccurate information cannot provide the district with a true assessment of costs related to its programs. Further, the State cannot rely on the district's J-380 for comparison with those submitted by other districts or as a true representation of program costs throughout the State.

The district's budget office is responsible for developing budget account codes, the manner in which the district classifies costs, and ensuring the integrity of the budget account structure. However, the budget office does not require that a duty statement be attached to a request to develop a new budget account code. Such a duty statement would allow the budget office to analyze each employee's duties and correctly allocate his or her functions to administration or instruction. Also, the procedures followed by the budget office do not require its staff to consult with the district's program accounting office, which is responsible for preparing the district's J-380, to determine if a position is classified correctly. As a result, for J-380 reporting purposes, the district may have based the position's classification on the position title alone, which does not always indicate the position's specific duties. Finally, the budget office does not perform a periodic review of existing budget account codes to ensure their integrity. Because the duties performed by an employee evolve over time, the district needs to evaluate periodically the accuracy of each position's classification.

Currently, to prepare the J-380, the district's automated systems produce reports to summarize program data. However, the district prepares manual adjustments to the data before entering the information on a J-380 computer spreadsheet template provided by the department.

The State enacted Senate Bill 94 (Chapter 237, Statutes of 1993), which establishes a standardized account code structure for California school districts. Establishing such an account code structure is expected to reduce the demands the current reporting process places on school districts and to expand

the State's access to school financial information without placing additional burdens on the schools. Legislators and administrators hope that the State can use the standardized account code structure to extract electronically the program cost data currently provided on the J-380.

Although the State's standard account code structure may reduce the time some districts take to prepare the J-380, it does not eliminate the need for the district to ensure that it classifies positions and duties correctly. If data is extracted electronically, there will not be an opportunity for the district to adjust the data manually before it submits the J-380. Therefore, even with the anticipated change in the reporting environment, the district's need to analyze positions with respect to functions performed is still necessary.

The District Appears To Have Classified School Site Administration Correctly; However, Some Problems Exist With the Classification of District Administrators

Certain associate and assistant superintendents should have been classified as a district administrative expense.

The J-380 report can be divided into two areas: instructional costs and noninstructional costs. The noninstructional costs include those for district administration, school site administration, and other expenditures, such as those for nonagency activities. For J-380 reporting purposes, district administration costs consist of salaries for superintendents and assistants as well as expenditures for centralized processes, such as purchasing and payroll. School site administration expenditures include the salaries of school principals, assistant principals, deans, clerks, etc. Also, for our analysis, this category covers expenditures for instructional activities that support teachers or students and instructional administration, such as curriculum development and teacher in-service training.

We selected a sample of employees the district classified as school site administration. Our testing indicates that, in general, the district has correctly classified these employees as school site administration. However, as discussed previously, the district has understated these costs because it has incorrectly classified as instructional costs some administrative duties performed by certain employees.

Some costs that we expected to be classified as district administration costs were not designated as such. We reviewed the district's organization chart dated August 1995 and selected for testing 10 employees. Of the 10 employees tested, we identified 3 employees, all of whom are assistant superintendents of instruction, who were classified as school site administration rather than district administration.

According to the CSAM, assistant superintendents are a district administrative cost and should be reported under the "General Support—Other Administrative Costs" category. This category includes the "salaries of the associate, area, and assistant superintendents; salaries of business managers, personnel directors, and directors of pupil services for the general direction and management of all affairs of the district. . ." Furthermore, we searched the CSAM for an exception to the rule and found that assistant superintendents of school districts may be charged in part to school site administration if they have "first-line responsibility for delivery of the services of the instructional administration program."

Based on our review of the district's organization chart for those working in Curriculum and Instruction, as pictured in Appendix C, on page 33, we determined that each of the assistant superintendents had two or more directors reporting to them. These assistant superintendents may, at times, work directly with principals. However, assistant superintendents and directors cannot logically have the same duties, such as "first-line responsibility for delivery of services of the educational administration program" related to adult education. Therefore, these assistant superintendents do not have first-line responsibility for delivery of services and do not meet the State criteria for classification as school site administration. If these individuals are performing the duties of an assistant superintendent, for which they are being paid, rather than the duties of a first-line director, their salaries should be classified as a district administrative expense.



District administration costs are understated by \$490,000 because five district administrators are misclassified as school site administration.



During our testing, we also reviewed the classification of the district's associate superintendent and the remaining assistant superintendent of instruction, and we determined that the district had classified these two additional employees as school site administration. However, based on the criteria presented in the CSAM as noted above, this classification is incorrect; these two additional employees should also be classified as district administration.

We reviewed the executive management salary list and calculated the annual salaries, including stipends and benefits at 25 percent of salary, for these five employees. As a result, if the district uses the information in its automated accounting system to prepare its fiscal year 1995-96 J-380, it could overstate its school site administration expenditures by as much as \$490,000. Conversely, district administration could be understated by an equal amount.

Finally, the district asserted that some costs it classifies as district administration may be inappropriately classified. We asked the district to identify the costs in question, and it provided information regarding the classification of certain centralized data processing costs. We analyzed the information provided and determined that the costs identified are correctly classified because they met the criteria established in the CSAM for the district administration classification rather than for school site administration.

Table 1 summarizes the total effect of all the misclassifications we found and the proportion of total district general fund expenditures the misclassifications represent.

Table 1

***Summary of Misclassified Costs
by J-380 Cost Category***

J-380 Cost Classification	Overstatement	Understatement	Misclassifications as a Percent of 1994-95 Reported Costs
Instructional:			
On-loan employees	\$ 740,000		
Early retirees	125,000		
TSA (projected error)	670,000		
Total Instructional	1,535,000		1.0%
School Site Administration:			
Early retirees		\$ 55,000	
TSA (projected error)		620,000	
District administrators	490,000		
Total School Site Administration	490,000	675,000	.7%
District Administration:			
Early retirees		70,000	
TSA (projected error)		50,000	
District administrators		490,000	
Total District Administration		610,000	4.0%
Nonagency Activities		740,000	*
Total	\$2,025,000	\$2,025,000	

*No costs were previously reported in this category.

While these misclassifications represent less than one percent of the district's total reported J-380 expenditures, they indicate that the district needs to change its procedures to classify correctly these types of costs in accordance with CSAM instructions for preparing the J-380 report.

Recommendations

To ensure that it categorizes and reports expenditures properly, the district should take the following steps:

- On its J-380, report as nonagency activities the cost of on-loan employees who are under contract to another educational entity;
- Report on its J-380, early retirees based on the job duties performed;
- Allocate to the appropriate budget code the cost of employees, such as TSAs, performing various duties;
- Report associate and assistant superintendents on its J-380 as a cost of district administration; and
- Review periodically, and at least annually, the duties performed by employees so that the district can classify the positions correctly.

Chapter 3

The District Has Strengthened Its Management Controls, but Tighter Controls Are Necessary

Chapter Summary

The Oakland Unified School District (district) has improved its management controls and financial position since January 1990, when the Office of the Auditor General (OAG) issued reports entitled "Because of Poor Management Controls, the Oakland Unified School District Is Not Adequately Protecting its Assets" and "A Review of the Oakland Unified School District's Financial Position." In these reports, the OAG recommended 37 changes for conditions that existed at the district. For 10 of the 37 OAG recommendations, we determined that no follow-up was necessary. Our review also found that the district had implemented 20 of the OAG recommendations. To respond to the remaining 7 recommendations, the district needs to tighten its controls over payroll, consulting contracts, and access to keys that open district facilities.

Some OAG Recommendations Do Not Require Our Follow-Up

For 6 of the 37 OAG recommendations, we performed no follow-up testing because the district's external auditors perform annual tests that cover controls over these management and financial areas. For example, in 1990, the OAG reported that the district did not comply with state requirements for reporting student attendance. Annually, the external auditors review the district's schedule of average daily attendance to ensure compliance with state requirements for reporting student attendance. The schedule reports the district's total average daily attendance during the school year.

For four other OAG recommendations, we found that the district had changed its management and accounting systems since 1990, so follow-up was unnecessary. For example, the OAG reported that the district had frequently miscalculated salary adjustments for staff reassignments. In 1991, the district

installed a new automated payroll accounting system, which prevents the types of miscalculations that occurred when accounting staff adjusted salaries manually.

The District Implemented Many of the OAG's Recommendations

The district implemented 20 of the 27 recommendations made in 1990 by the Auditor General's office.

During our review, we tested the district's current conditions and found that it had implemented 20 of the remaining 27 OAG recommendations. For example, in 1990, the OAG reported that the district's board of education (board) did not preapprove sabbatical leave. Further, one employee did not purchase indemnity bonds to protect the district financially should the employee fail to fulfill the terms of the sabbatical agreement. Since 1990, the district has granted a sabbatical to only one employee. The sabbatical lasted for five months during 1991, and the employee has remained with the district since her return from sabbatical. Our review of the employee's file indicated that the district appropriately followed its policies and procedures in granting the sabbatical.

In 1990, the OAG also reported that the district granted doctoral stipends to administrators without obtaining evidence that the individuals met the district's requirements for receiving a doctoral stipend. In our review of ten current administrators receiving doctoral stipends, we found documentation that all of the administrators were qualified to receive the funds.

Further, in 1990, the OAG reported that the district did not meet requirements for updating its conflict-of-interest code, which specifies the type of employees who must file statements of their economic interests. The district updated its conflict-of-interest code in 1991. In addition, in our review of ten current school administrators who are required to file statements of economic interest, we found that all of the employees had current statements on file.

The Oakland Unified School District Needs To Tighten Its Control Over Payroll, Contracts, and Keys

In our examination of the remaining seven situations for which the OAG had recommended changes, we found that the district continues to need improvements in its control over payroll, contracts, and access to keys. Good internal control practices dictate that the district maintain adequate controls for payroll charges processed by its payroll system, approval and payment

of consultant contracts, and employee access to keys. Our tests identified errors and weaknesses in controls that were not individually significant but that collectively indicate the district's need to further improve its management controls.

Weaknesses in Controls Over Payroll

In our survey of ten classified employees, we found these problems with internal controls:

- A school principal inappropriately approved two time sheets for one employee. Each time sheet listed different duties but covered the same days and times. Subsequently, two payroll clerks each processed one of the employee's time sheets. Each clerk was unaware that another time sheet existed. The approvals resulted in an overpayment of \$310.
- The district overpaid another employee \$810 for extra time worked. The employee reported .75 hours (or 3/4 of an hour) of extra time worked. Because of a clerical error, the district paid the employee for 75 hours extra time.
- An employee correctly reported leave without pay; however, the district recorded that time as sick leave. This error resulted in an overpayment to the employee of \$50.

In our test of payroll information for ten management employees, we found the following:

- The district did not properly post a two-day absence that one employee reported. When we informed the payroll department about this error, it corrected the transaction.
- The district recorded vacation leave for one certificated administrative employee. However, district policy provides that certain certificated administrative employees work a required number of days but do not earn vacation leave. According to the district's "Policies and Regulations Relating to Administrative Employees," dated 1983-84, certificated administrative employees who are not represented for collective bargaining purposes are required to work between 190 to 209 work days, but they do not earn vacation. However, according to the assistant superintendent for human resources, certain certificated administrators began receiving vacation by order of the then-superintendent in 1992. Also, the assistant superintendent stated that,

The district accrued vacation credits for an administrative employee not eligible to earn this benefit.

although he issued a directive to cease vacation accrual for certificated administrative employees beginning August 1995, the district continued to accrue vacation credit through June 1996. On July 18, 1996, he issued a memorandum directing the district's payroll department to cease accruing vacation time for certificated administrators.

Our testing indicates that the district needs to improve management controls over its payroll. Unless the district processes payroll documents accurately, errors will occur and go undetected.

Weaknesses in Controls Over Contracts

The district has improved its consultant contract practices since the OAG issued its report in January 1990. Specifically, the district revised its contracting procedures to ensure that it obtains board approval of consultant contracts and that it makes payments to consultants only after receiving evidence of contract existence or documentation of services received. Nonetheless, during our test of ten consultant contracts, we found the following minor weaknesses:

- In 1 of 10 contracts tested, we found that the consultant signed the Statement of Services Performed and that the district approved the statement for payment before the consultant had performed the services. However, the district did not pay the consultant until after the time period the consultant was to perform the services.
- In another instance, the board did not approve the contract until the end of the last month that the consultant was to provide services.

Although the district has improved its contracting practices, it needs to adhere to its policies on documenting completion of services and obtaining board approval before contractors provide goods or services.

Weakness in Control Over Keys to Facilities

The OAG's January 1990 report states that the district did not limit access to keys for multiple facilities to trustworthy individuals and to as few of those as possible. While we found

no evidence that individuals with such keys are not trustworthy, we could not determine whether the district has limited employees' access to keys that open multiple facilities.

Based on our interviews of officials at four school sites and the three district area offices for elementary, middle, and high schools, we determined that employees do not consistently follow the district's policy covering key management. The policy requires officials at the school sites to have a written policy for protecting keys at their schools and to submit the policy to the district area offices. However, the officials at three of the four school sites did not provide us with such a policy covering both room and master keys, and one of the four officials was unaware of the requirement. Additionally, the area offices did not have copies of any written policy from their schools for protecting keys.

Moreover, district policy requires that keys be submitted to the responsible manager when employees leave the district. However, the district's maintenance department was unable to provide us with documentation that it follows this policy for the individuals who receive "grand master" keys. The district records list 142 individuals in various positions who have been issued those keys that open all doors and gates in the district.

Recommendations

To ensure that it pays employees only what they are entitled to receive, the district should take the following actions:

- Make sure that supervisors who approve time sheets verify that the employee actually worked the hours recorded on the time sheet; and
- Direct its internal auditor to review the potential for payroll problems arising from supervisors' approval of time sheets, employees' submitting more than one time sheet, and payroll clerical errors.

To make certain that it pays for services that it requires and that it has received, the district should do the following:

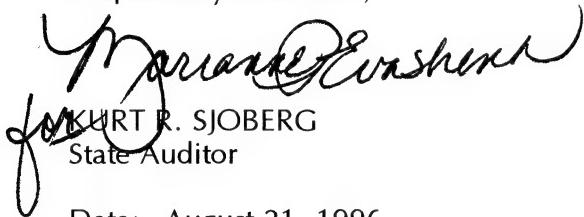
- Confirm the completion of work certified as performed; and
- Ensure that consultants do not perform services before the board approves the consultants' contracts.

To safeguard its assets, the district should take the following steps:

- Ensure that each school site prepares a written policy to protect room and master keys at its school; and
- Document in writing the return of district keys by district employees who are terminating their employment.

We conducted this review under the authority vested in the state auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope of this report.

Respectfully submitted,


KURT R. SJÖBERG
State Auditor

Date: August 21, 1996

Staff: Philip Jelicich, CPA, Audit Principal
Jeffrey Winston, CPA
Willie D. Benson, Jr.
Dave Frizzell
Sharon L. Smagala, CPA

Appendix A

Audited and Projected Unrestricted General Fund Revenues, Expenditures, and Changes in Fund Balances for the Years Ending June 30, 1995 Through 1999 (In Thousands)

	1995 Audited	1996 Estimated	1997 Budget	1997 Projected	1998 Projected	1999 Projected
Revenues:						
Revenue limit sources	\$157,284	\$163,151	\$166,886	\$167,176	\$172,708	\$177,647
Federal revenues	128	128	128	128	128	128
Other state revenues	8,592	10,352	10,312	13,129	10,450	9,950
Other local revenues	2,606	3,186	3,414	3,414	3,414	3,414
Total Revenues	168,610	176,817	180,740	183,847	186,700	191,139
Expenditures:						
Salaries	116,648	118,904	124,169	124,169	130,693	132,994
Employee benefits	31,639	32,815	33,164	33,164	34,400	35,107
Books and supplies	3,361	3,339	3,132	3,132	3,132	3,132
Contracted services and other operating expenses	10,690	13,411	12,206	12,206	12,322	12,471
Capital outlay	1,036	1,027	1,132	1,132	1,131	1,132
Other outgo	1,994	1,062	1,302	1,302	1,347	1,370
Direct support and indirect costs	(6,406)	(6,741)	(6,423)	(6,423)	(6,423)	(6,423)
Total Expenditures	158,962	163,817	168,682	168,682	176,602	179,783
Other Financing Sources (Uses):						
Transfers in	302	130	102	102	130	130
Transfers out	(2,170)	(2,313)	(2,741)	(2,740)	(2,742)	(1,893)
Contributions to other programs	(8,985)	(7,723)	(8,818)	(8,818)	(8,954)	(9,123)
Total Other Financing Sources (Uses)	(10,853)	(9,906)	(11,457)	(11,456)	(11,566)	(10,886)
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	(1,205)	3,094	601	3,709	(1,468)	470
Fund Balance, Beginning of Year	5,492	4,287	7,381	7,381	11,090	9,622
Fund Balance, End of Year	\$ 4,287	\$ 7,381	\$ 7,982	\$ 11,090	\$ 9,622	\$ 10,092

Notes: See Appendix A, pages 28 and 29, for descriptions of the assumptions used by the district in preparing projected revenues and expenditures for the years ending June 30, 1998, and June 30, 1999.

The 1997 budget column represents the district budget as approved by the board of education on June 26, 1996.

The 1997 projected data represents subsequent analysis performed by the district.

***Assumptions the District Used in Preparing
Its Projection of Fund Balances for the Years
Ending June 30, 1998, and June 30, 1999***

In preparing the general fund's unrestricted programs' projection of revenues and expenditures for the years ending June 30, 1998, and June 30, 1999, the district made the following material assumptions:

1. The state revenue limit cost-of-living adjustments (COLA) for fiscal years 1997-98 and 1998-99 will be 2.30 percent and 2.86 percent, respectively.
2. The state revenue limit deficit reduction for fiscal years 1997-98 and 1998-99 will be 10.12 percent.
3. For fiscal years 1997-98 and 1998-99, the district will reacquire 450 days of average daily attendance (ADA) that it lost during the 1995-96 teachers strike. This reacquisition will increase revenue for these two fiscal years by approximately \$1.6 million. However, in its projection, the district assumed no corresponding increase in teacher salary expense.
4. Personnel will generally receive salary increases equal to the revenue limit COLA minus one percent.
5. Counselor positions reduced by the Oakland Education Association labor agreement, yet reinstated due to the board of education action in fiscal year 1996-97, are excluded from salary projections.
6. Major health insurance benefits will generally increase by the rate of the COLA.
7. Salary-driven benefits will increase in proportion to salary increases.
8. Other operating expenses will either remain flat or increase by the rate of the COLA.
9. The district will receive funding for one-time school site grants in fiscal year 1996-97. The use has not yet been determined, and thus the district has included \$3.0 million in fund balance as designated for one-time school grants.

The district's financial forecast is based on assumptions concerning future events and circumstances. Because some assumptions may not materialize and unanticipated events and circumstances may occur after the date of this forecast, the

actual results during the forecast period may differ from the forecasted results. For example, the district has not included the effect, if any, of the implementation of the grades 1-3 class size reduction. These differences may be material.

Appendix B

Audited and Projected Unrestricted General Fund Balances for the Years Ending June 30, 1995 Through 1999 (In Thousands)

	1995 Audited	1996 Estimated	1997 Budget	1997 Projected	1998 Projected	1999 Projected
Fund Balances:						
Reserved						
Inventory Revolving cash account	\$ 343 65	\$ 224 65	\$ 224 65	\$ 224 65	\$ 224 65	\$ 224 65
Total Reserved	408	289	289	289	289	289
Unreserved:						
Designated for economic uncertainties	3,879	4,952	5,100	5,100	5,100	5,100
Designated for one-time school grants				3,180	3,180	3,180
Designated for one-time expenses to be decided	2,140	2,593	2,521	2,521	2,521	2,521
Designated for budget surplus/(deficit)*				(1,468)	(998)	
Total Unreserved	3,879	7,092	7,693	10,801	9,333	9,803
Total Fund Balances	\$4,287	\$7,381	\$7,982	\$11,090	\$9,622	\$10,092

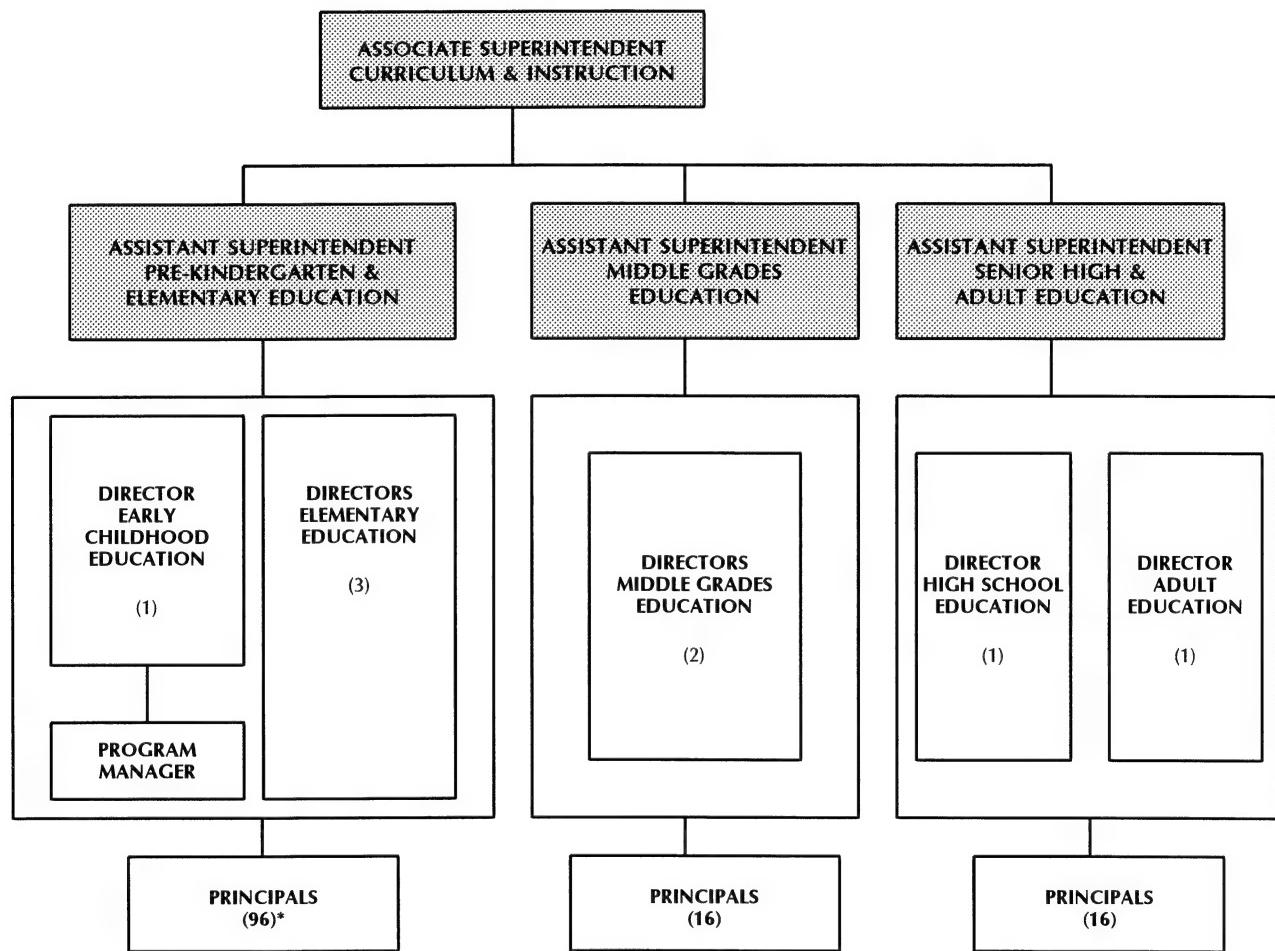
Notes: *This line monitors the cumulative effect of revenues exceeding, or not exceeding, expenses.

The 1997 budget column represents the district budget as approved by the board of education on June 26, 1996.

The 1997 projected data represents subsequent analysis performed by the district.

Appendix C

Oakland Unified School District's Curriculum and Instruction Organization Chart



*Note: Includes 37 child development centers.

The shaded area above represents four of the five positions discussed in Chapter 2, page 17, that do not have first-line responsibility for an educational program.



OAKLAND UNIFIED SCHOOL DISTRICT

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Board of Education 1996

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Deputy Secretary &
Executive Assistant

August 16, 1996

Mr. Kurt R. Sjoberg
State of California Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

The Board of Education of the Oakland Unified School District wishes to express its appreciation for the conduct and preparation of the audit report entitled, *Oakland Unified School District: Current Practices Have Improved Its Financial Condition*. Your report acknowledges the significant efforts of the District to improve its management structure and achieve financial solvency.

Your audit verifies that the District has submitted balanced budgets, increased its Reserve for Economic Uncertainties in accordance with the plan developed with the Alameda County Office of Education, and instituted collective bargaining practices that align salary increases with cost of living adjustments.

The audit further demonstrates the need for the State of California Department of Education to provide a uniform account code structure for school districts that will provide for consistent classification and reporting of information on the Annual Report of Program Costs (J-380). We are confident that our participation in the piloting of the state-wide uniform account code structure will assist the California Department of Education.

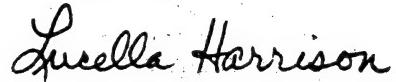
Most importantly, the report documents that the District has worked diligently to meet the unique educational needs of our students, and at the same time, maintain a fiscally responsible budget. We believe that this report, coupled with the previously issued (March 12, 1996) audit entitled *Oakland Unified School District: A Review and Comparison of Various Costs* will establish a factual basis for future discussions of the allocation of District resources.

Mr. Kurt R. Sjoberg
State of California Auditor
Page 2

The District is committed to addressing the recommendations included in this report.

Enclosed is the District's response to the audit which highlights key points in the report and provides the rationale for specific actions.

Sincerely,



Lucella T. Harrison
President

LTH:gt
ltr816
Attachment

Oakland Unified School District

Response to Bureau of State Audits Report August 16, 1996

Overview

During the 1995-96 fiscal year, the Joint Legislative Audit Committee requested that the Bureau of State Audits review the Oakland Unified School District's spending patterns during the period 1992-93 through 1994-95 and to compare its administrative costs with those of six comparable districts. The results of the audit were issued March 12, 1996, and verified that:

- The overall administrative costs of the Oakland Unified School District was in the mid-range of the comparison districts (Exhibit 1). Oakland spent 6.17% of its total budget on central office administration, of which 4.22% was related to unrestricted and special education program costs and 1.95% was restricted fund program cost.
- The District spends an additional 10.64% of its general fund budget on school site administrative costs, ranking second highest among the comparison districts. This is a result of the disproportionate number of small schools compared to state-wide averages.
- Oakland has the second highest per pupil spending on classroom instructional costs among the comparison districts.
- Pupil services costs, including nurses, counselors, psychologists, and attendance workers, was the highest among the six comparison districts and represented 8.09% of the general fund budget.

A subsequent audit was requested by the Joint Legislative Audit Committee (1) to analyze the District's current financial condition; (2) to evaluate the accuracy and propriety of reporting of administrative, instructional and support services costs in the State required J-380 Report; and (3) to follow-up on the findings and recommendations made by the Office of the Auditor General in reports issued in 1989 and 1990.

This report, *Oakland Unified School District: Current Practices Have Improved Its Financial Condition*, presents the findings of the second phase of the audit.

The District responds to the current report as follows:

Current Practices Result in Balanced Budgets, Adequate Reserves, and Controlled Teacher Salary Increases

Beginning in the 1989-90 fiscal year, the Oakland Unified School District worked with the Alameda County Office of Education and an advisory trustee, appointed pursuant to Assembly Bill 2525, to develop a Five Year Recovery Plan. While the goal of the plan was to ensure the financial solvency of the District, its specific emphasis was to increase the Reserves for Economic Uncertainty to the State-mandated 2% level over five years. The report documents the significant improvements in the District's financial condition. It must be noted that the District and the Alameda County Office of Education agreed upon the \$3.9 million reserve for economic uncertainties for fiscal year 1994-95 with the understanding that the 2% requirement would be met in the following year. The recovery plan did not anticipate that the State-mandated level would be achieved prior to 1995-96. A reserve designated for economic uncertainties of \$5 million was included in the budget approved by the Board of Education on June 28, 1996.

Given that 94% of the District's unrestricted general fund budget is appropriated to salaries and benefits, increases in these areas must be linked to on-going increases in revenue. During negotiations, costs in teacher salaries were projected through the year 2000, and the costs exceed revenue for fiscal year 1997-98 only. This is due primarily to the fact that the 12% salary increase will be paid for the entire fiscal year. The District will take action to reduce expenditures and/or use enhanced revenues to meet this obligation. Thereafter, salary increases are tied to cost of living adjustments.

Some of the District's Costs May Not Have Been Correctly Classified on the J-380 Report

The Annual Program Cost Data Report (J-380) is used to calculate the rate of indirect costs to be charged to restricted or categorical programs. The California State Department of Education acknowledges that statewide, school districts inconsistently report information. Therefore, the District requested that the scope of this audit be expanded to include a sampling of the reporting classifications in school districts comparable to Oakland. The Bureau of State Audits declined the District's request. If such an analysis would have been completed, we believe that it would have verified that school districts throughout the state do not uniformly interpret the cost classifications.

In addition, the findings are prospective and represent projected overstatements and understatements of costs. The findings assume that the classifications used in the 1994-95 report would be used in the 1995-96 report which, to date, has not been completed as it is due to the California Department of Education in September.

(1) *

(2)

*California State Auditor's comments on this response begin on page 43.

The following outlines the District's rationale for the classification of costs:

- On-loan employees are teachers whose salaries and benefits are paid by the contracting agency (University of California, Berkeley; Mills College; and California Department of Education) to provide support to District classroom teachers in the implementation of various instructional program.
- The early retirees noted were members of the Oakland Education Association (OEA) prior to their retirement and should have been providing instructional services.
- Teachers on Special Assignment (TSAs) are required to spend 80% of their time in direct instruction. The District will ensure that school site and program managers appropriately assign tasks and monitor personnel.
- Assistant Superintendents for Pre-Kindergarten and Elementary, Middle Grades Education, and Senior High and Adult Education are directly responsible for schools, and as such were classified as instructional administration.

Of the \$2,025,000 reported as overstated or understated costs, \$670,000 are projected rather than actual costs and \$740,000 are costs for which the District is reimbursed by other agencies.

Recognizing the deficiencies of the J-380, the California Department of Education is developing a uniform account code and reporting structure. Oakland Unified School District is piloting the new format this fiscal year. When implemented statewide, the system will eliminate the discrepancies in reporting among school districts.

Management Controls Have Been Strengthened and Tighter Controls are Necessary

The report points out the significant accomplishment made by the Oakland Unified School District to improve its management controls and its financial position. Of the 37 recommendations made by the Office of the Auditor General in 1990, this audit found that the District had implemented 20 of the recommendations and that no follow-up was required on 10 recommendations.

(3)

The District is committed to continuing to monitor and improve its internal controls to ensure that its assets are adequately protected.

OAKLAND UNIFIED SCHOOL DISTRICT

ERRATA SHEET

In order to ensure the accuracy of the report, the District wishes to correct the following misstatements/errors:

- Page 1-2 The Reserve for Economic Uncertainty agreed to by the State and County under the Five Year Recovery Plan, was \$3.9 million for 1994-95. Thus, the shortfall of \$1.1 million as stated in the report did not exist. (4)
- Page 1-3 The District estimated savings from increased student-counselor ratio to be \$1.3 million, not \$1.2 million. (5)
- Page 1-4 The collective bargaining agreement with teachers specified a one-time bonus, not a pay increase. (6)
For fiscal 1996-97, the increase is anticipated to average 5.47%, a 3% increase through March 1997 and an additional 9% increase for three months, not 12%. (7)
- Page 2-1 An Associate Superintendent and four (4) Assistant Superintendents of Instruction were charged to instructional administration (EDP Code 375) not school site administration (EDP Code 385). (8)
- Page 2-8 The percentage of the overstatement and understatement included in Table 1 are based upon 1995-96 estimates and projections; while the percentage of total reported cost is based upon 1994-95 data. Therefore, the percentage of the total report costs may be inaccurate. (9)
- Page 2-7 The Associate Superintendent and Assistant Superintendent were classified as Instructional Administration, not school site administration. (8)
- Page A-2 #9 The \$2.5 million for one-time school grants is actually \$3.0 million (see B-1). (10)
- Page A-3 CTA vs Gould is included in projections. (11)
Changes in lottery are included in projections.

OAKLAND UNIFIED SCHOOL DISTRICT EXHIBIT 1

RESPONSE TO BUREAU OF STATE AUDITS REVIEW AND COMPARISON OF VARIOUS COSTS

DISTRICT OFFICE ADMINISTRATIVE SUPPORT COST

FISCAL 1994-5

	UNRESTRICTED & SPECIAL ED	RESTRICTED	TOTAL
SAN JUAN	9.07%	0.83%	9.90%
SAN FRANCISCO	8.35%	0.00%	8.35%
SACRAMENTO CITY	6.58%	0.87%	7.45%
SAN BERNARDINO	5.67%	0.43%	6.10%
OAKLAND	4.22%	1.95%	6.17%
SANTA ANA	3.93%	0.32%	4.25%
GARDEN GROVE	3.06%	0.28%	3.34%

SORTED BY UNRESTRICTED/SPECIAL ED

REFER TO TABLE 3

Comments

California State Auditor's Comments on the Response From the Oakland Unified School District

To provide clarity and perspective, we are commenting on the Oakland Unified School District's (district) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- (1) We did not go to other school districts because the scope of this audit was never intended to verify whether school districts throughout the State uniformly interpret the cost classifications. In addition, for the types of misclassifications we found, the criteria was explicit.
- (2) As the district accurately states, and as we state on page 12 of this report, we based our review on the fiscal year 1995-96 costs as classified in the district's automated accounting system rather than on amounts reported on the district's Annual Program Cost Data Report (J-380) for fiscal year 1995-96 because the district has not yet prepared the J-380 for fiscal year 1995-96. Further, as stated on page 3 of this report, the purpose of our audit was not to restate data submitted by the district to the State in prior years nor to compare the district with other districts in the State. Rather, it was to evaluate the district's process for preparing the J-380 and to identify discrepancies between how its automated accounting system was summarizing costs for the district's J-380 and the State's directions for reporting costs on the J-380.
- (3) The district is incorrect in assuming that the uniform account code structure will eliminate reporting discrepancies between school districts. The new system may allow for the electronic extraction of data by the California Department of Education, as we discuss on page 16 of the report. Therefore, the new account code structure is even more dependent on the correct classification of costs because the opportunity for review and manual adjustment of these costs by the district is reduced.

- (4) The district's point is not clear. Apparently, because of a different goal for fiscal year 1994-95 as stated in the district's Five-Year Recovery Plan (recovery plan) with the State and county, it believes the State's recommendation that school districts maintain a reserve equal to 2 percent of expenditures and other uses is not relevant to an analysis of the district's financial strength. We believe our statements on page 6 provide accurate context for measuring the district's financial strength against both the 2 percent recommendation for other school districts and the goal contained in the recovery plan as stated in the district's fiscal year 1994-95 audit report. The district's annual financial and compliance audit report stated that the district was \$300,000 below the target of \$4.2 million for June 1995 contained in the recovery plan.
- (5) Text changed to the district's representation of \$1.3 million. However, based on the calculation that the district informed us it used, the amount should have been \$1.2 million.
- (6) As we describe on page 8, the fiscal year 1995-96 payment to teachers was a one-time payment that did not change the salary rate schedule. To be consistent with the district's terminology, we changed "pay increase" to "one-time bonus."
- (7) The district is incorrect when it implies our report states that there was an "additional 12 percent increase" for three months. Our report states "consisting of an approximately 3 percent increase for the first seven months and an approximately 12 percent increase for three months." We further clarified our sentence by the subsequent sentence that stated that the total increase from the beginning of the year to the end of the year was 12 percent.
- (8) While the district's comment that these individuals are classified as instructional administration is accurate, it does not change how they should have been classified. We clarified the text on page 16 of the report. For our analysis, school site administration includes "expenditures for instructional activities that support teachers or students and instructional administration, such as curriculum development and teacher in-service training." Based on the criteria in the California School Accounting Manual (CSAM), as discussed on page 17 of this report, the associate superintendent and assistant superintendents of instruction are a district administration cost and are therefore misclassified.
- (9) The district has misunderstood the percentages shown in Table 1, page 18 of this report. The amounts listed in Table 1 are not presented as a precise calculation of the misclassifications made by the district, but rather to provide

context for the magnitude of the misclassifications we found in the district's accounting system. We based our percentage of total reported cost upon 1994-95 data because the 1995-96 data was not yet available and because school district expenditures are relatively constant.

- (10) Text changed based on subsequent information we received from the district.
- (11) Text changed based on subsequent information we received from the district.

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps